CRÉDIT AGRICOLE

How long will the boom in construction last ? (2)

MACRO MAP

This week

- **The most important event this week will be the release of data on non-farm payrolls in the US scheduled for Friday.** We expect the employment to have increased by 325k in October vs. 33k in September, with unemployment rate up to 4.3%. The sharp increase in employment was largely due to the abatement of the adverse effect of hurricanes Harvey and Irma on activity in the US economy (last month the number of people who were employed but were unable to work due to weather conditions reached the record high level for September – see MACROmap of 9/10/2017). We expect that the annual dynamics of average hourly earnings dropped to 2.6% YoY in October vs. 2.9% in September. Before the Friday's reading some additional information on the labour market will be provided by the ADP report on private sector employment (the market expects an increase by 200k in October vs. 135k in September). The results of US business surveys will also be released this week. We forecast that the ISM index for manufacturing dropped to 59.2 pts in October vs. 60.8 pts in September, which was in line with the results of regional business surveys. In turn the Conference Board Consumer Confidence Index rose to 121.0 pts in October vs. 119.8 pts in September. Our forecast of average hourly earnings dynamics is below the market consensus (2.7%), therefore its materialization will be slightly positive for PLN and the prices of Polish bonds.
- **FOMC meeting will be held on Wednesday.** We expect that the target range for the Federal Reserve funds will be left at an unchanged level. In our view, the statement after the meeting will not provide any new information substantially altering our scenario of the US monetary policy, in which FED will hike interest rates by 25bp in December 2017. We expect that the release of the statement after the FOMC meeting will be neural for the financial markets.
- **Important data from the Eurozone will be released this week.** The flash estimate of HICP inflation will be released on Tuesday. We expect that the inflation rate stood at 1.6% YoY in October vs. 1.5% in September. We forecast that the quarterly economic growth rate in the Eurozone dropped to 0.5% in Q3 vs. 0.6% in Q2. We expect the publication of data on higher than expected inflation in the Eurozone to be slightly negative for PLN and prices of the Polish debt. In turn, the publication of an in-line-with-the-consensus GDP estimate should not be market moving.
- **The October PMIs for Chinese manufacturing (Caixin and CFLP) will be released this week**. We forecast that Caixin PMI slightly rose to 51.5 pts vs. 51.0 pts in September, while PMI according to CFLP dropped to 52.1 pts vs. 52.4 pts in September. We expect that the results of business surveys in China, pointing to a stabilization of sentiment in manufacturing, will be neutral for PLN and yields on Polish bonds.
- **Data on the October inflation in Poland will be released on Tuesday. In our view it dropped to 2.1% YoY vs. 2.2% in September.** We believe that inflation rate decreased due to lower dynamics of fuel prices. The preliminary data on inflation are likely to be neutral for PLN and yields on Polish bonds.
- **Data on business sentiment in Polish manufacturing will be released on Thursday.** We expect that PMI dropped to 53.5 pts from 53.7 pts in September. In our view, the growth rate of manufacturing activity was slower due to the deterioration in Germany (see below). The materialization of our forecast, which is lower from the market consensus (54.0 pts) will be slightly negative for PLN and yields on Polish bonds.

Last week

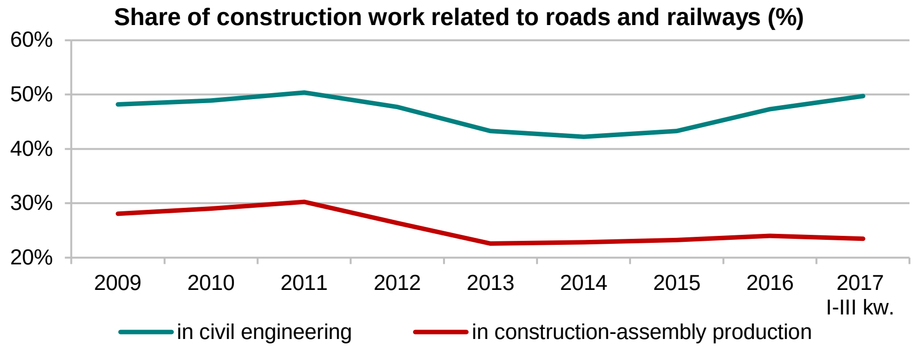
- **The ECB meeting was held last week.** The Board decided to extend the expanded asset purchase program by 9 months – i.e. "at least until September 2018". The scale of purchase will be reduced from EUR 60bn down to EUR 30bn per month starting from January. The ECB decision is in line with one of the scenarios presented in the last week's MACROmap. The ECB repeated that interest rates would most likely be left at the current level for an extended period of time, significantly exceeding the horizon of the asset purchase program (so-called forward guidance). The fragment saying that the ECB is ready to increase the scale or extend the horizon of the asset purchase program has also been left unchanged. The clause saying that the recent foreign exchange rate volatility is a source of uncertainty for medium-range inflation prospects has been deleted from the statement. The ECB decision and the statement after the meeting were received by the market as dovish and led to EUR depreciation vs. USD. We believe that at the June meeting the ECB will decide to extend the asset purchase program at least until December 2018. At the same time we expect that the ECB interest rates will be left unchanged at least until September 2019.

- **Hard data from the US economy and business survey results were released last week.** According to the flash estimate, the US GDP growth rate dropped to 3.0% in Q3 vs. 3.1% in Q1, which was above the market expectations (2.5%). The slight decrease in the economic growth rate resulted from lower contributions of private consumption (1.62 pp in Q3 vs. 2.24 pp in Q2) and investments (0.25 pp vs. 0.53 pp). Higher contributions of inventories (0.73 pp vs. 0.12 pp), net exports (0.41 pp vs. 0.21 pp), and government expenditures (-0.02 pp vs. -0.03 pp) had an opposite impact. Thus, like in Q2, private consumption was the main source of US GDP growth in Q3. Noteworthy in the data structure is the increased contribution of inventories, which in our view is largely due to the effects of hurricanes Irma and Harvey. In reaction to the better-than-expected data on the US GDP, EUR depreciated vs. USD. Preliminary data on durable goods orders were also released last week. They increased by 2.2% MoM in September vs. a 2.0% increase in August, which was mainly the result of higher dynamics of orders for means of transport (the effect of increase in orders in the Boeing company). Excluding means of transport, the monthly growth rate of durable goods orders has not changed in September compared to August and stood at 0.7%. Especially noteworthy in the data structure is a sharp increase in the annual dynamics of orders for non-military capital goods excluding orders for aircrafts (7.8% YoY in September vs. 4.1% in August – the highest level since April 2012), being the leading indicator for future investments. Data on new home sales (667k in September vs. 561k in August) were also released last week, pointing to an increase in activity in the US real estate market. Improvement in consumer sentiment was also indicated by the final University of Michigan Index, which rose to 100.7 pts in October vs. 95.1 pts in September and 101.1 pts in the flash estimate. The index increase resulted from higher values of its sub-indices for both the assessment of the current situation and expectations. The last week's data from the US economy support our scenario in which FED will hike interest rates by 25 bp in December 2017.
- **Flash November business sentiment indicators (PMI) for major European economies were released last week.** Composite PMI for the Eurozone dropped to 55.9 pts in October vs. 56.7 pts in September and 56.0 pts in Q3. The index declined due to lower value of the indicator in Germany (56.9 pts in October vs. 57.7 pts in September) and its increase in France (57.5 pts vs. 57.1 pts). The deterioration in Germany occurred due to lower sub-index concerning output in manufacturing and lower sub-index concerning business activity in the services sector. The improvement in France resulted from higher sub-indices for both output in manufacturing and business activity in the services sector. Other Eurozone countries covered by the survey also recorded a slight deterioration of sentiment. Especially noteworthy in the structure of data concerning the situation in German manufacturing are persistently high levels of the sub-indices for both new total orders and new foreign orders. This boosts the demand for the goods that are made in Poland and are used in the production of final products. We forecast that the quarterly GDP growth rate in the Eurozone will not change in Q4 compared to Q3 and will amount to 0.5%.
- **Ifo Index reflecting the sentiment among German managers representing the manufacturing, construction, wholesale and retail trade sectors, rose to 116.7 pts in October vs. 115.3 pts in**

September, hitting the highest level in history. The index increased due to higher sub-indices concerning both the assessment of the current situation and expectations. Sector-wise, improvement of sentiment was recorded in three of the four segments (retail trade, manufacturing, and construction), while the situation in wholesale trade deteriorated. The data pose a slight upside risk to our forecast, in which the quarterly GDP growth rate in the German economy will decrease to 0.5% in Q4 vs. 0.6% in Q3.

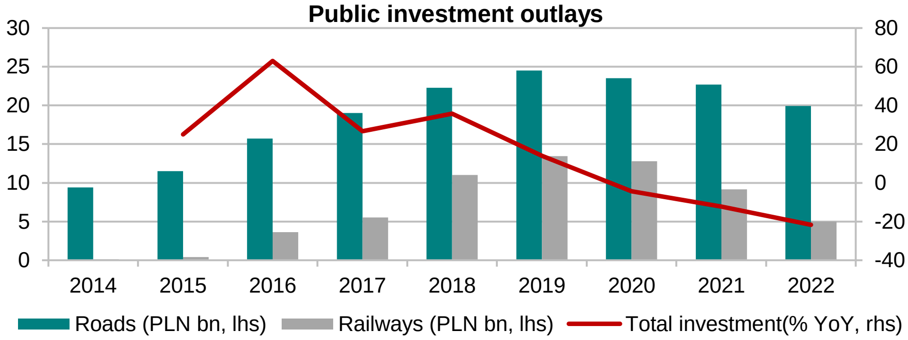
- **On Friday Catalonia declared independence.** In reaction to Catalonia's decision, under Article 155 of the constitution, the government in Madrid took direct control over Catalonia stripping it of its autonomy, dissolved the Catalan government headed by C. Puidgemont, and called for early elections in the region. The increase of tension in Spain was conducive on Friday to EUR weakening vs. USD. We expect that possible further escalation of the Spanish-Catalan conflict may support increased volatility in the financial markets.
- **Last week the House of Representatives passed a budget blueprint in the US for 2018.** It assumes increased defense spending with a simultaneous reduction of expenditure for foreign aid and healthcare for senior and poorest citizens. The adopted budget bill includes an amendment which prevents the Democrats to use parliamentary obstruction during the vote on the tax system reform. This increases the likelihood of D. Trump delivering on the election promises by easing fiscal policy. Consequently, the adoption of the bill was conducive to increase in yields on US bonds at the long end of the curve.

How long will the boom in construction last ? (2)



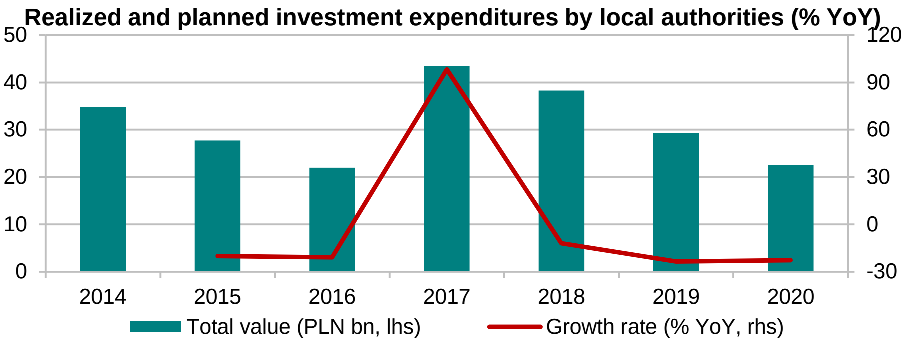
Source: GUS, Credit Agricole

Below we present a subsequent part of our analysis of long-term outlook for construction. This time we are presenting this topic from the point of view of public investment profile. According to available information, investments consisting in the construction of civil engineering works, in particular of road, railway and utilities (e.g. energy) infrastructure will constitute a substantial part of public outlays. The profile of infrastructural investments is important from the point of view of forecasting the construction-assembly production, as in several recent quarters the value of construction-assembly production related to road or railway works represented 40-50% of production in the segment "civil engineering works" and 20-30% of total construction-assembly production.



Source: KPK to 2023, PBDK 2014-2023 (update from 12.07.2017), Credit Agricole

Investment plans in the said sections have been presented in a concise manner in two documents: "The National Roads Construction Program for 2014-2023" (hereinafter NRPP) and "The National Railway Program until 2023" (hereinafter NRP). The cross-sectional review of energy investments until 2030 published by the Ministry of the State Treasury provides for the implementation of projects worth several billions of zlotys in the next few years. The NRP and the NRPP indicate that total outlays for road and railway investments in 2017 will increase by 26.6% YoY and by 35.7% in 2018. At the same time it will be the peak of the recovery. From 2019 the dynamics of public investments in this segment will decrease to fall below zero as from 2020.



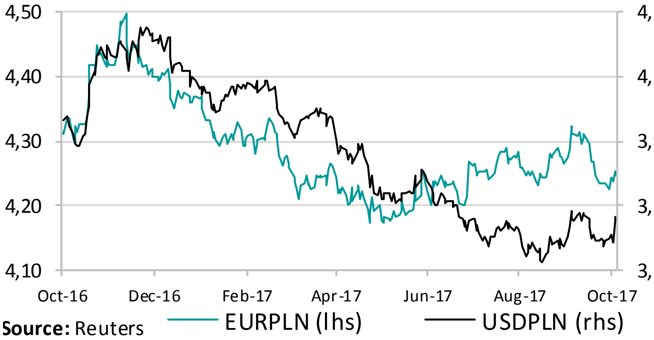
Source: Ministry of Finance, Credit Agricole

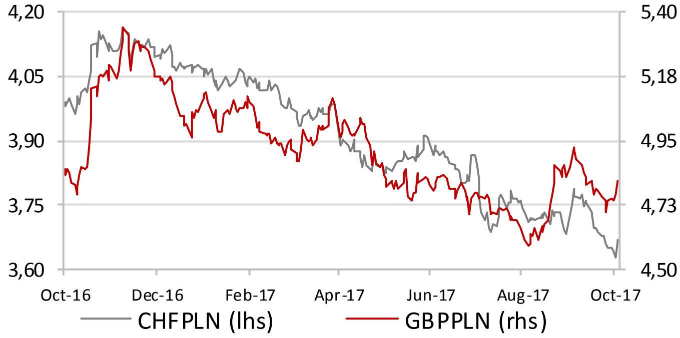
Multiyear Financial Forecasts (MFF) are another source of information about infrastructural investments, this time those financed by local government units (LGUs). MFFs are descriptions of internally consistent actions of local governments planned in the perspective of at least three years and related to accumulation and disposal of cash resources from the point of view of achieving objectives in the area of organization and provision of public and social goods. MFFs describe inter alia the planned investment projects to be implemented by LGUs in subsequent years. To determine the amount of total outlays on fixed assets of all the LGUs, the investment plans of single units must be added up. According to the data we have collected on the implementation of budgets and forecasts of expenditures, the dynamics of LGU investments should increase from -20.9% YoY in 2016 to 98.3% in 2017. According to the forecasts included in the MFFs, a decrease in LGU outlays on fixed assets in annual terms is forecasted starting from 2018.

However, the estimates of investment expenditures presented in MFFs should be treated with caution. In the MACROmap of 5/6/2017 we have presented an in-depth analysis of LGU investment expenditures. Based on the available data for 2003-2016, we have observed that real investment expenditures were on the average 15.5% lower than assumed in the budget plans. We therefore believe that the actual profile of investment expenditures of LGUs will differ markedly from the one presented in the MFF. We expect that the decrease in the dynamics of investment outlays in 2018 will not be that sudden. High investment expenditures will be supported by the elections to the local governments. Thus the profile of outlays for fixed assets presented in the MFF and described above will be smoother. Like the analysis in the previous MACROmap, the factors outlined above support our scenario in which the boom in infrastructural investments will end at the turn of 2018-2019.

Data from the US labour market may strengthen PLN

FX rates



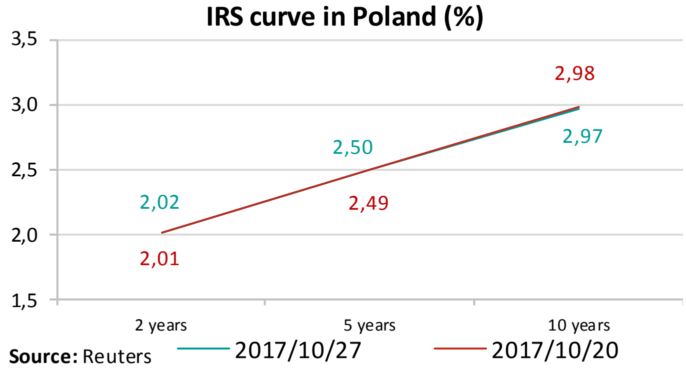


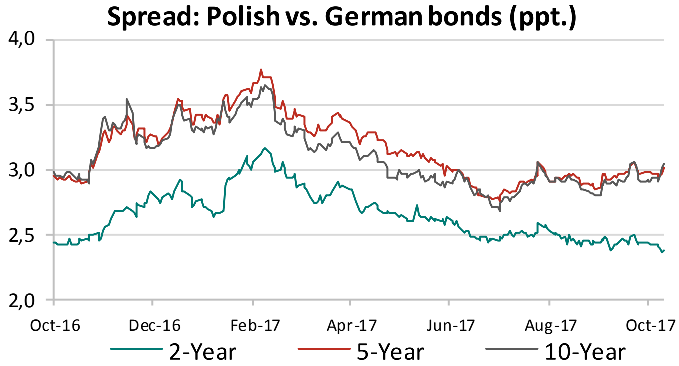
Source: Reuters

Last week EURPLN rate rose to 4.2468 (PLN weakening by 0.3%). Last week EURPLN stayed within a weak upward trend. The most important event for PLN was the Thursday's ECB meeting. Its decision concerning the evolution of the expanded asset purchase program was received by the market as dovish (see above), consequently it led to a temporary strengthening of PLN. Last week PLN was strongly depreciating vs. USD due to PLN weakening vs. EUR given a simultaneous fall of EURUSD rate. EUR depreciated vs. USD due to the above-mentioned dovish tone of the ECB meeting and the publication of better-than-expected data on GDP in the US.

This week the focus will be on preliminary data on inflation in the Eurozone. If our higher-from-the-market-consensus forecast materializes, their publication may be conducive to a weakening of PLN. The results of business survey for Polish manufacturing (PMI) will also be negative for PLN. On the other hand the data from the US labour market may be conducive to PLN strengthening. FOMC meeting will be neutral for the market, we believe. The releases of preliminary data on inflation in Poland, GDP in the Eurozone, and business survey results for China manufacturing will have a limited impact on PLN.

Market focuses on Eurozone inflation data





Source: Reuters

Last week 2-year IRS rates rose to a level of 2.02 (up by 1 bp), 5-year rates to a level of 2.50 (up by 1 bp), and 10-year rates dropped to a level of 2.9671 (down by 1 bp). The most important event on the Polish debt market last week was the Thursday's ECB meeting. Its dovish tone led to a decrease in IRS rates visible especially in the centre and at the long end of the curve. A debt auction was held on Wednesday at which the Finance Ministry sold PLN 8.0bn of 3-, 5-, 9-, 10-, and 30-year bonds with demand amounting to PLN 11.78bn. The auction brought about a fall of IRS rates at the short end of the curve.

This week the Polish debt market will focus on the preliminary data on inflation in the Eurozone. We believe that their publication will support an increase in IRS rates. The publication of Polish manufacturing PMI will have a similar impact. On the other hand, the Friday's data from the US labour market may contribute to a fall of IRS rates. FOMC meeting will be neutral for the Polish debt market, we believe. In our view, the preliminary data on inflation in Poland and GDP in the Eurozone will have a limited impact on IRS rates.

Forecasts of the monthly macroeconomic indicators

Main monthly macroeconomic indicators in Poland														
Indicator	**Sep-16**	**Oct-16**	**Nov-16**	**Dec-16**	**Jan-17**	**Feb-17**	**Mar-17**	**Apr-17**	**May-17**	**Jun-17**	**Jul-17**	**Aug-17**	**Sep-17**	**Oct-17**
NBP reference rate (%)	1,50	1,50	1,50	1,50	1,50	1,50	1,50	1,50	1,50	1,50	1,50	1,50	1,50	1,50
EURPLN*	4,29	4,31	4,45	4,40	4,32	4,31	4,23	4,23	4,18	4,23	4,25	4,25	4,31	**4,28**
USDPLN*	3,82	3,92	4,20	4,18	4,00	4,07	3,97	3,88	3,72	3,70	3,59	3,57	3,65	**3,61**
CHFPLN*	3,93	3,96	4,13	4,11	4,04	4,05	3,96	3,90	3,84	3,86	3,72	3,72	3,77	**3,73**
CPI inflation (% YoY)	-0,5	-0,2	0,0	0,8	1,7	2,2	2,0	2,0	1,9	1,5	1,7	1,8	2,2	
Core inflation (% YoY)	-0,4	-0,2	-0,1	0,0	0,2	0,3	0,6	0,9	0,8	0,8	0,8	0,7	1,0	
Industrial production (% YoY)	3,2	-1,3	3,2	2,2	9,1	1,1	11,0	-0,6	9,1	4,5	6,2	8,7	4,3	
PPI inflation (% YoY)	0,2	0,6	1,8	3,2	4,0	4,5	4,8	4,2	2,4	1,8	2,2	3,0	3,1	
Retail sales (% YoY)	4,8	3,7	6,6	6,4	11,4	7,3	9,7	8,1	8,4	6,0	7,1	7,6	8,6	
Corporate sector wages (% YoY)	3,9	3,6	4,0	2,7	4,3	4,0	5,2	4,1	5,4	6,0	4,9	6,6	6,0	
Employment (% YoY)	3,2	3,1	3,1	3,1	4,5	4,6	4,5	4,6	4,5	4,3	4,5	4,6	4,5	
Unemployment rate* (%)	8,3	8,2	8,2	8,3	8,6	8,5	8,1	7,7	7,4	7,1	7,1	7,0	6,8	
Current account (M EUR)	-874	-14	-97	-106	2548	-514	-405	459	-297	-1114	-491	-100		
Exports (% YoY EUR)	3,5	-1,0	4,3	9,0	15,1	6,4	19,7	2,5	18,5	6,5	12,4	12,3		
Imports (% YoY EUR)	3,5	1,3	5,2	9,8	16,0	10,5	19,8	3,8	20,4	13,0	12,8	7,6		

*end of period

Forecasts of the quarterly macroeconomic indicators

Main macroeconomic indicators in Poland												
Indicator		**2017**				**2018**				**2016**	**2017**	**2018**
		Q1	**Q2**	**Q3**	**Q4**	**Q1**	**Q2**	**Q3**	**Q4**			
Gross Domestic Product (% YoY)		**4,0**	**3,9**	**4,3**	**4,2**	**4,0**	**3,7**	**3,6**	**3,8**	**2,9**	**4,1**	**3,8**
Private consumption (% YoY)		**4,7**	**4,9**	**4,2**	**4,5**	**4,6**	**4,3**	**4,3**	**3,9**	**3,9**	**4,6**	**4,3**
Gross fixed capital formation (% YoY)		**-0,4**	**0,8**	**3,0**	**5,5**	**7,9**	**7,0**	**6,8**	**6,1**	**-7,9**	**3,0**	**6,7**
Export - constant prices (% YoY)		**8,3**	**2,8**	**8,0**	**10,0**	**8,0**	**7,7**	**6,8**	**5,5**	**8,8**	**7,3**	**7,0**
Import - constant prices (% YoY)		**8,7**	**6,1**	**9,0**	**11,6**	**10,6**	**10,0**	**10,4**	**8,3**	**7,9**	**8,9**	**9,8**
GDP growth contributions	**Private consumption (pp)**	**3,0**	**2,9**	**2,5**	**2,3**	**3,0**	**2,6**	**2,6**	**1,9**	**2,9**	**2,7**	**2,5**
	Investments (pp)	**0,0**	**0,1**	**0,5**	**1,3**	**0,9**	**1,1**	**1,2**	**1,5**	**-2,1**	**0,5**	**1,2**
	Net exports (pp)	**0,1**	**-1,5**	**-0,3**	**-0,4**	**-1,1**	**-0,8**	**-1,8**	**-1,3**	**0,9**	**-0,6**	**-1,2**
Current account*		**0,1**	**-0,5**	**-0,7**	**-1,2**	**-1,7**	**-1,5**	**-1,7**	**-2,0**	**-0,3**	**-1,2**	**-2,0**
Unemployment rate (%)**		**8,1**	**7,1**	**6,8**	**7,3**	**7,6**	**6,8**	**6,9**	**7,3**	**8,3**	**7,3**	**7,3**
Non-agricultural employment (% YoY)		**2,1**	**2,4**	**1,9**	**1,0**	**0,3**	**0,1**	**0,1**	**0,1**	**1,9**	**1,9**	**0,2**
Wages in national economy (% YoY)		**4,1**	**5,0**	**5,6**	**6,0**	**6,4**	**6,7**	**6,6**	**6,5**	**3,8**	**5,2**	**6,5**
CPI Inflation (% YoY)*		**2,0**	**1,8**	**1,9**	**1,8**	**1,5**	**1,9**	**1,6**	**1,5**	**-0,6**	**1,9**	**1,6**
Wibor 3M (%)**		**1,73**	**1,73**	**1,73**	**1,73**	**1,73**	**1,73**	**1,90**	**1,98**	**1,73**	**1,73**	**1,98**
NBP reference rate (%)**		**1,50**	**1,50**	**1,50**	**1,50**	**1,50**	**1,50**	**1,50**	**1,75**	**1,50**	**1,50**	**1,75**
EURPLN**		**4,23**	**4,23**	**4,31**	**4,16**	**4,15**	**4,12**	**4,10**	**4,07**	**4,40**	**4,16**	**4,07**
USDPLN**		**3,97**	**3,70**	**3,65**	**3,41**	**3,40**	**3,35**	**3,31**	**3,26**	**4,18**	**3,41**	**3,26**

* quarterly average
** end of period
***cumulative for the last 4 quarters

Calendar

TIME	COUNTRY	INDICATOR	PERIOD	PREV. VALUE	FORECAST*	
					CA	CONSENSUS**
		Monday 10/30/2017				
11:00	Eurozone	Business Climate Indicator (pts)	Oct	1,34		1,41
13:30	USA	Real private consumption (% MoM)	Sep	-0,1		
14:00	Germany	Preliminary HICP (% YoY)	Oct	1,8	1,80	1,70
		Tuesday 10/31/2017				
2:00	China	Caixin Manufacturing PMI (pts)	Oct	52,4	52,1	52,0
11:00	Eurozone	Preliminary GDP (% QoQ)	Q3	0,6	0,5	0,5
11:00	Eurozone	Preliminary HICP (% YoY)	Oct	1,5	1,6	1,4
11:00	Eurozone	Unemployment rate (%)	Sep	9,1		9,0
14:00	USA	Case-Shiller Index (% MoM)	Aug	0,3		0,2
14:00	**Poland**	**Flash CPI (% YoY)**	**Oct**	**2,2**	**2,1**	**2,1**
14:45	USA	Chicago PMI (pts)	Oct	65,2		60,5
15:00	USA	Consumer Confidence Index	Oct	119,8		121,0
		Wednesday 11/01/2017				
2:45	China	Caixin Manufacturing PMI (pts)	Oct	50,2	51,5	51,0
13:15	USA	ADP employment report (k)	Oct	135		200
15:00	USA	ISM Manufacturing PMI (pts)	Oct	60,8	59,2	59,5
15:45	USA	Flash Manufacturing PMI (pts)	Oct	54,5		
19:00	USA	FOMC meeting (%)	Nov	1,25	1,25	1,25
		Thursday 11/02/2017				
9:00	**Poland**	**Manufacturing PMI (pts)**	**Oct**	**53,7**	**53,5**	**54,0**
9:55	Germany	Final Manufacturing PMI (pts)	Oct	60,5	60,5	60,5
10:00	Eurozone	Final Manufacturing PMI (pts)	Oct	58,6	58,6	58,6
13:00	UK	BOE rate decision (%)	Oct	0,25	0,50	0,50
		Friday 11/03/2017				
13:30	USA	Unemployment rate (%)	Oct	4,2	4,3	4,2
13:30	USA	Non-farm payrolls (k MoM)	Oct	-33	325	310
15:00	USA	ISM Non-Manufacturing Index (pts)	Oct	59,8	57,6	58,6
15:00	USA	Factory orders (% MoM)	Sep	1,2	1,6	1,3

*The forecasts of macroeconomic indicators for Poland were prepared by Credit Agricole Bank Polska S.A. The forecasts of foreign indicators were prepared by Crédit Agricole Corporate and Investment Bank

** Reuters

Jakub BOROWSKI
Chief Economist
tel.: 22 573 18 40
jakub.borowski@credit-agricole.pl

Krystian JAWORSKI
Senior Economist
tel.: 22 573 18 41
krystian.jaworski@credit-agricole.pl

Jakub OLIPRA
Economist
tel.: 22 573 18 42
jakub.olipra@credit-agricole.pl